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C O N F I D E N T I A L BAKU 000726

SIPDIS

EUR FOR MATT BRYZA; EEB FOR BOYDEN GRAY AND STEVE MANN

E.O. 12958: DECL: 08/03/2018
TAGS: [ECIN](#) [ECON](#) [ENRG](#) [EPET](#) [PGOV](#) [PINR](#) [PREL](#) [AZ](#) [TU](#)
SUBJECT: AZERBAIJAN PRESIDENT, SPECIAL ENVOY GRAY DISCUSS
NEXT STEPS IN ENERGY COOPERATION

REF: A. BAKU 719
[1](#)B. BAKU 721

Classified By: Classified By: Ambassador Anne E. Derse, Reasons 1.4 (b, d)

[1](#)1. (C) SUMMARY: In a July 14 meeting with Special Envoy Gray, President Aliyev sought USG views on how to best proceed on the Southern Corridor project. SE Gray reaffirmed the U.S. commitment to work with Turkey and the EU to enable gas transit. To entice Turkmenistan into shipping gas west, Aliyev remained convinced that any final consumer needed to take the initiative to buy gas at the Turkmen border. President Aliyev was unhappy with Secretary Rice's comments in Prague implying a lack of democracy in Azerbaijan, saying "such comments are not helpful." Clear in this meeting with President Aliyev was his eagerness to accept guidance from the USG on how to move forward vis-a-vis gas transit through Turkey, and to a lesser extent, bilateral energy cooperation with Turkmenistan. Also palpable was his assessment that Azerbaijan could rely on no one else, in the face of a "full-court press" by Russia, lack of progress on transit with Turkey, confusing correspondence with Turkmenistan and perceived problems with BP. END SUMMARY

[1](#)2. (C) On July 14 Special Presidential Envoy for Eurasian Energy C. Boyden Gray, Eurasian Energy Coordinator Ambassador Steve Mann and Ambassador Derse met with President Aliyev. Also present were (on the U.S. side) U.S. Trade and Development Agency Regional Director Dan Stein, Department of Energy Director of Russian and Eurasian Affairs Lana Ekimoff, and Embassy Energy Officer, and (on the GOAJ side) Presidential Personal Assistant Ali Asadov.

TURKEY TRANSIT

[1](#)3. (C) SE Gray gave President Aliyev a read-out of his July 9-13 Turkey visit. He sensed an energy policy split within the GOT, an impression supported by other knowledgeable observers with whom he had spoken. In separate meetings, a positive and upbeat PM Erdogan and MFA U/S Apakan (FM Babajan was out of town) seemed eager to cooperate with Azerbaijan and the West in energy sector development and on Southern Corridor projects. The PM was also very positive about his Nakhchivan June 4 meeting with President Aliyev. However in SE Gray's meeting with the Energy Minister, a brusque Guler focused exclusively on getting Azerbaijan to fulfill its "promise" to Turkey of eight billion cubic meters annually (bcm/a) of Shah Deniz Phase Two (SD2) gas. Guler said that the GOT could facilitate the transit of the other five bcm/a of SD2 to Europe through its own internal pipeline network,

obviating the need for any new pipeline, and not factoring in any gas for Georgia. SE Gray told Aliyev that the PM had suggested a energy working group between the U.S. and the GOT MFA, which he interpreted as a manifestation of the PM's desire to shift responsibility for Southern Corridor energy issues from the Energy Ministry to the Foreign Ministry, rumors of which he has heard elsewhere.

14. (C) Aliyev said Azerbaijan had made no "promise" of 8 bcm/a to Turkey. He did not believe there was such an internal policy split, or that the Energy Ministry could be acting independently. SE Gray's information "complicates our plans," since "there would be nothing left" of SD2 were the GOAJ to sell 8 bcm to Turkey. "If we agree to their demands for 8 bcm, what will be their demands in the future?" President Aliyev has told SOCAR that if there is no agreement on transit through Turkey, SD2 development should not be sanctioned (COMMENT: In a subsequent conversation between SOCAR Vice-President Elshad Nassirov and Eurasian Energy Coordinator Ambassador Steven Mann, Nassirov requested that this Presidential dictum linking SD2 development to fair transit not be communicated to the GOT, as the GOAJ was seeking indirectly to persuade Turkey that the GOAJ was seeking other export options for SD2 gas not involving transit through Turkey END COMMENT).

TURKEY: SDI PRICING

15. (C) On the negotiations between Botas and the Shah Deniz Consortium for a new price for the Shah Deniz Phase One (SD1) gas being sold to Turkey, Aliyev said the new price must be a

market price. However, there has been "no progress" with Botas, and the matter could end up in arbitration (COMMENT: For the first year of SD production gas was sold to Turkey at the sub-market price of USD 120 per thousand cubic meters (tcm) due to the pricing algorithm devised at the time of the PSA, when oil was being sold at USD 18 dollars per barrel. This algorithm had in it an oil ceiling price of a then-unimaginable USD 40 per barrel. Once the new price is agreed between Botas and the SD Consortium, it will be applied retroactively to the date of April 15, 2008. END COMMENT)

16. (C) Aliyev said it was unacceptable that countries such as Turkey, Georgia and Ukraine, with no energy production themselves, seek to present themselves as "energy suppliers." Turkey was seeking to "separate the sources from the market," but Azerbaijan would not let this happen. Turkey should seek to act in accordance with international practice, and not seek to impose terms on consumers and producers. SD's "competition" (i.e. Russia) was working actively to subvert the Southern Corridor by putting pressure on (inter alia) Turkey. Aliyev said that the future of SD1 was uncertain and now, given GOT intransigence, there was no clear picture of whom SD2 consumers would be. For the first of many times in this meeting, he said that he "does not know what to do" about Turkey.

17. (C) SE Gray said Russia's threat not to renew Turkey's six bcm/a gas supply contract expiring in 2011 was clearly an attempt to pressure Turkey. However, there was no European response to Russia's clear attempts to dominate the European gas market. More generally, SE Gray said that one could not understand EU energy policy without understanding its priorities. Western Europe won't recognize its own gas needs, since it cannot admit it cannot meet its climate change goals without vast amounts of additional gas. Gray explained that Western Europe was focused almost exclusively on meeting its climate change goals, ignoring the threat of Gazprom's gas monopoly. The United Kingdom's goal in all this was to become the world's major carbon trading center.

NEXT STEPS

18. (C) In response to President Aliyev's repeated question

of what to do next, SE Gray enumerated the following steps:

- ONE: Go forward with the GOT Foreign Ministry energy working group proposed by the PM, to test if the GOT is serious in seeking USG help in "re-ordering its house" or is just indulging in a "good cop-bad cop" routine, as President Aliyev believes. Try for periodic meetings of such a group to move the various issues forward, and to see if indeed the PM is seeking to sideline the Energy Ministry and empower the MFA in energy policy.

- TWO: Get Brussels more active. EU Secretary General Javier Solana has become interested in the energy issue, and SE Gray was scheduled to meet with his deputy the coming week. "If Solana become involved, it is a different picture," since he is far more effective than the relatively weak EC President Jose Manuel Barroso, who is beholden to and seeking to curry favor with the French.

GOTX - BUYERS MUST ACT

¶9. (C) Aliyev said he was surprised that Azerbaijan had recently once again received a diplomatic note from Turkmenistan protesting GOAJ development of the ACG offshore field (septel), which he saw as inconsistent with the positive bilateral cooperation exhibited by Turkmenistan on the possibility of offshore bilateral energy cooperation and on the upcoming September joint energy conference and exhibition. Aliyev ascribed this letter to "Russia being active" in Ashgabat, to include its offers of buying GOTX gas at "market price."

¶10. (C) When Hungarian Prime Minister Gyurcsany recently asked him as to what to do to expedite Turkmen integration into the western energy grid, Aliyev said he told him that "those who want to buy Turkmen gas must act now." Turkmenistan was considering a cross-Caspian option, but wants to sell its gas at the border, so buyers must be ready and willing to buy it at the border. Aliyev told Gyurcsany

that he should sign an MOU with Turkmenistan and one with Azerbaijan in this regard. Azerbaijan was willing to buy GOTX gas at the border, but only if "all the other pieces were in place," to include final customers and assured transit. Aliyev added that the EU would be wise to invest in any potential pipeline from Turkmenistan to Azerbaijan, much as Russia is doing with Southstream.

¶11. (C) Ambassador Mann said that until the major IOCs are allowed into Turkmenistan to develop the upstream sector, it is bootless to focus on buying large volumes from Turkmenistan, because such uncommitted volumes won't be available. Instead, initially a consortium should develop the Turkmen upstream sector. In a recent meeting with Head of State Agency for Hydrocarbon Resources Baimurat Muradov, there were indications that the GOTX was "re-thinking" its proscription on international companies pursuing onshore development. Aliyev said that such fundamental changes will take time, and that he has seen no signs of such a changing policy. Even if the GOTX were to adopt a new policy towards exporting to the West, implementation will take time, with typical gas development until production taking seven to eight years. Meanwhile, the Southern Corridor project was facing unexpected obstacles such as Turkey, and the June announcement that Austria would join Southstream, which if true would "kill Nabucco." Azerbaijan is the "easiest part" of the Southern Corridor project, Aliyev said, "Everywhere else there are problems." In response to a question from USTDA Stein, Aliyev said that the GOAJ had contemplated LNG across the Black Sea, which might make sense, given that it had its own terminal (i.e. Kulavi).

GOTX EARLY GAS

¶12. (C) Mann presented Aliyev with a two-page paper, "Pathway to 'Early Gas' from Turkmenistan and Beyond," listing steps the GOAJ and GOTX could take to interconnect their offshore gas infrastructures. Aliyev said that

technically it wouldn't be hard to do, if Berdimukhamedov had the political will. Mann said that he repeatedly has told the GOTX President to diversify gas exports, since if Berdimukhamedov relies on Russian belief in sanctity of contract, "Turkmenistan's only recourse will be in a Moscow court" if the Russians go back on their promise of a "market price" for GOTX gas. Aliyev agreed that Russian assurances of a market price to the GOTX rang hollow, and that if Turkmenistan had no alternative export routes, it wouldn't get a market price from Gazprom.

¶13. (C) Aliyev said that neither the GOTX nor the GOAJ could be the initiator of any cross-Caspian project. Rather, "the consumers must initiate." But, all those with an interest in such a project, to include individual European countries, Turkey and BP were all under Russian Pressure. Azerbaijan, Aliyev underscored, is alone in its full support for the Southern Corridor and in resisting Russian pressure. Gray agreed with Aliyev, saying that it was clear that Russia wished to vitiate the Southern Corridor Project and buy Caspian gas for itself, as opposed to investing money into additional production in places such as Yamal. Gray said his concern was that if the TNK-BP project ended badly, "no western company will want to go to Russia." Aliyev said Russia needs additional resources, but instead was focusing on seeking to block alternative supply to Russia. Russia should be investing in projects with IOCs to increase production, not in "strange pipelines" like Southstream.

¶14. (C) Aliyev said BP continued to relay bad news, having recently informed Azerbaijan that there would be less associated gas from the ACG field than expected, and that the start of SD2 production would be delayed by one year (COMMENT: Publicly the SD Consortium has said that SD2 production would start o/a late 2013, while privately it has commented that the start would probably be later). Aliyev said he "did not exclude" Russian pressure on BP with respect to its activities in Azerbaijan. If Russia were to "separate Azerbaijan from Europe," then it could dominate European gas markets, hence BP could be an important tool for Russia in this regard.

SEPTEMBER CONFERENCE

¶15. (C) SE Gray said he would discuss high-level USG

attendance at the September 9-10 Azerbaijan-Turkmenistan Energy Conference and Exhibition in Baku. (COMMENT: In a separate meeting between SOCAR Marketing VP Nassirov and Ambassador Mann, Nassirov said that GOTX President Berdimukhamedov would not be attending this conference, as he felt that he could not again return to Baku until Aliyev had made a visit to Ashgabat. The senior GOTX official would be Vice-Premier for Oil and Gas Tachberg Tagiev).

SEC RICE PRAGUE COMMENTS

¶16. (C) Aliyev commented he had noted Secretary Rice's comments to Radio Liberty in Prague as to how oil-rich countries experienced a decrease in democracy. Seeming to quote from memory, he cited the Secretary as saying that "these countries cannot be ruled as in the eighteenth century," and that "pressure must be put on these leaders from both the top and the bottom . . . my message to these leaders . . . they must know that freedom will not fail." Aliyev said that these comments directed towards Kazakhstan, Uzbekistan, Azerbaijan and Turkmenistan "were not helpful," to include her specific referral to Turkmenistan - "these kinds of things create questions."

¶18. (C) COMMENT: Clear in this meeting with President Aliyev was his frustration with surrounding parties in terms of natural gas development, marketing and transport. While eager to accept guidance on the "way forward" from the USG, Aliyev decried Turkey's intransigence on transit as the key

underlying problem. Lack of progress on SD1 pricing and excessive demands for SD2 gas have further muddied the waters with Ankara. Aliyev, as always, pointed to Russian pressure on potential partners, including Turkey, Turkmenistan and BP, and noted that following the Medvedev/Miller visit, Russia is even a meddler in Azerbaijan. Mixed signals from the GOTX, bad news from BP, heightened Russian regional activity and inaction out of Brussels, in Aliyev's view, has left Azerbaijan "alone," and led the President to suggest more openly that Azerbaijan forego the sanctioning of SD2.

¶19. (U) Ambassadors Gray and Mann have cleared this cable.
DERSE